

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



**FINANCIAL EXAMINATION
OF**

**Unigard Insurance Company
Bellevue, Washington**

**NAIC CODE 25747
DECEMBER 31, 2002**

Exhibit A

**Participating States:
Washington
Oregon**

CHIEF EXAMINER AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Unigard Insurance Company of Bellevue, Washington. This report shows the financial condition and related corporate matters as of December 31, 2002.

A handwritten signature in black ink, reading "Patrick H. McNaughton", written over a horizontal line.

Patrick H. McNaughton
Chief Examiner

10-19-04

Date

TABLE OF CONTENTS

<u>SCOPE OF EXAMINATION</u>	1
<u>INSTRUCTIONS</u>	1
<u>COMMENTS AND RECOMMENDATIONS</u>	7
<u>COMPANY PROFILE</u>	8
HISTORY	8
TERRITORY AND PLAN OF OPERATION	8
ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS, PURCHASES, AND SALES	8
GROWTH OF COMPANY	8
<u>AFFILIATED COMPANIES</u>	9
<u>MANAGEMENT AND CONTROL</u>	10
OWNERSHIP	10
BOARD OF DIRECTORS	11
OFFICERS	12
CONFLICT OF INTEREST	13
FIDELITY BOND AND OTHER INSURANCE	13
OFFICERS', EMPLOYEES', AND AGENTS' WELFARE AND PENSION PLANS	14
<u>CORPORATE RECORDS</u>	14
<u>LOSS EXPERIENCE</u>	14
<u>REINSURANCE</u>	15
<u>STATUTORY DEPOSITS</u>	17
<u>ACCOUNTING RECORDS AND PROCEDURES</u>	18
<u>SUBSEQUENT EVENTS</u>	18
<u>FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS</u>	19
<u>FINANCIAL STATEMENTS</u>	19
<u>ACKNOWLEDGMENT</u>	25
<u>AFFIDAVIT</u>	26

Seattle, Washington
October 19, 2004

The Honorable Kevin McCarty
Chair, NAIC Financial Condition (E) Committee
Director of Insurance Regulation
Florida Dept. of Financial Services
The Larson Bldg., 200 E. Gaines St., Room 101
Tallahassee, FL 32399-0301

The Honorable Joel Ario
Insurance Administration, Oregon Insurance Division
350 Winter Street NE Room 440
Salem, OR 97301-3883

The Honorable John Morrison
Commissioner, Montana Department of Insurance
NAIC Secretary, Western Zone
840 Helena Avenue
Helena, MT 59601

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance 5000 Building
5000 Capital Blvd.
Tumwater, WA 98504-0255

Dear Commissioners:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an Association examination was made of the corporate affairs and financial records of

Unigard Insurance Company
of
Bellevue, Washington

hereinafter referred to as "UIC" or the "Company," at the location of its home office, 15805 NE 24th Street, Bellevue, Washington 98008-2409. This report is respectfully submitted showing the financial condition of the Company as of December 31, 2002.

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 1997 through December 31, 2001, carried forward through December 31, 2002, and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records along with external reference materials from the NAIC and the Internal Revenue Service (IRS) along with various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's and internal audit work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2002 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC's Accounting Practices and Procedures Manual.

Based on our materiality threshold, no adjustments were required. Reclassification and adjusting entries are shown for informational purposes only. The following summarizes the exceptions noted while performing this examination.

1. Misclassification of Vehicle and Auto and Related Accumulated Depreciation

The Company incorrectly classified the costs for vehicles and related accumulated depreciation, as Other Assets Not Admitted. The 2002 NAIC Annual Statement Instructions state: "Automobiles, airplanes and other vehicles..." should be included on the Aggregate Write-Ins for Other than Invested Assets line. As of December 31, 2002, the total amount misclassified for vehicles and related accumulated depreciation was \$290,346 and \$96,829 respectively.

The Company is instructed to record vehicle and auto costs, and related depreciation, on the correct NAIC Annual Statement line as required by RCW

48.05.250 and the NAIC Annual Statement Instructions. In order to properly reflect the amount of vehicle and auto costs, the following reclassifications are needed:

	<u>Debit</u>	<u>Credit</u>
Aggregate write-ins other than invested assets non-admitted	\$290,346	
Other assets non-admitted		\$290,346
Other assets non-admitted	\$96,829	
Aggregate write-ins for other than invested assets non-admitted		\$96,829

Subsequent to the date of this examination and prior to the last day of field work, the Company made these reclassification entries.

2. Misclassification of Non-Admitted Qualified Pension Plan Assets

The Company incorrectly classified non-admitted qualified pension plan assets as Other Assets Non-admitted. Other Assets Non-admitted is limited to the following pre-printed line items:

- Bills receivable that are not for premiums
- Furniture, equipment and supplies
- Leasehold improvements
- Loans on personal security

Non-admitted qualified pension plan assets should be included in Aggregate Write-ins for Other Than Invested Assets. The Aggregate Write-ins for Other Than Invested Assets line is for assets for which there is no pre-printed line. The total misclassification as of December 31, 2002 was \$78,979.

The Company is instructed to properly classify non-admitted qualified pension plan assets in the NAIC Annual Statement as required by RCW 48.05.250 and the NAIC Annual Statement Instructions. In order to properly reflect the amount of non-admitted qualified pension plan assets, the following reclassification is needed:

	<u>Debit</u>	<u>Credit</u>
Aggregate write-ins for other than invested assets non-admitted	\$78,979	
Other assets non-admitted		\$78,979

Subsequent to the date of this examination and prior to the last day of field work, the Company made this reclassification entry.

3. Misclassification of Drafts Outstanding

The Company incorrectly classified drafts outstanding in its 2002 NAIC Annual Statement as Amounts Withheld or Retained by Company for Account of Others. Drafts outstanding should be recorded in the NAIC Annual Statement as Drafts Outstanding. The total misclassification as of December 31, 2002 was \$58,280.

The Company is instructed to properly classify drafts outstanding in the NAIC Annual Statements as required by RCW 48.05.250 and the NAIC Annual Statement Instructions. In order to properly reflect the amount of drafts outstanding, the following reclassification is needed:

	<u>Debit</u>	<u>Credit</u>
Amounts withheld or retained by company for account of others	\$58,280	
Drafts outstanding		58,280

Subsequent to the date of this examination and prior to the last day of field work, the Company made this reclassification entry.

4. Misclassification of Commission Payable

The Company incorrectly classified commissions payable in its Annual Statement as Other Expenses. Commissions Payable should be recorded as Commissions Payable, Contingent Commissions and Other Similar Charges in the Annual Statement.

The NAIC Annual Statement Instructions state: "Commissions Payable, Contingent Commissions and Other Similar Charges include contingent commissions based upon profitability of the business produced, its persistency, loss ratio development and other criteria." The total amount misclassified as of December 31, 2002 was \$2,233,751.

The Company is instructed to properly classify commissions payable in the NAIC Annual Statement as required by RCW 48.05.250 and the NAIC Annual Statement Instructions. In order to properly reflect the amount of commissions payable, the following reclassification is needed:

	<u>Debit</u>	<u>Credit</u>
Other expenses (excluding taxes, licenses and fees)	\$2,233,751	
Commissions payable, contingent commissions...		\$2,233,751

Subsequent to the date of this examination and prior to the last day of field work, the Company made this reclassification entry.

5. Misclassification of Taxes, Licenses and Fees

The Company incorrectly classified Washington State sales tax as Other Expenses in its NAIC Annual Statement. Washington State sales tax should be recorded as Taxes, Licenses and Fees.

The Company is instructed to properly classify Washington State sales tax in the NAIC Annual Statements as required by RCW 48.05.250 and the NAIC Annual Statement Instructions. No reclassifying entry is required due to immateriality.

Subsequent to the date of this examination and prior to the last day of field work, the Company made this reclassification entry.

6. Misclassification of Furniture and Equipment Operating Lease

The Company incorrectly included accrued expenses for an operating lease as Remittances and Items not Allocated in the NAIC Annual Statement. Accrued expenses for operating leases should be included as Other Expenses in the NAIC Annual Statement. Based on paragraph 9 of SSAP 67, "Remittances and Items not Allocated is reserved for cash receipts which can't be identified for a specific purpose." The appropriate statement line for accrued expenses related to an operating lease would be Other Expenses. The NAIC Annual Statement Instructions state that Other Expenses should include "...incurred but unpaid other underwriting and investment expense, excluding taxes, licenses and fees."

The Company is instructed to properly classify accrued expenses for operating leases as required by RCW 48.05.073 and the NAIC Annual Statement Instructions. No reclassification entry was required due to immateriality.

Subsequent to the date of this examination and prior to the last day of field work, the Company made this reclassification entry.

7. Stock Register

The Company does not maintain a stock register or stock transfer book that tracks changes in ownership of the Company. We reviewed three stock certificates that indicate Unigard Inc., owns all of the authorized and issued shares of Unigard Insurance Company. The examination staff asked to view the Company's stock register to determine if the three certificates represent the only shares outstanding. The Company was unable to produce a stock register, or any other official Company record. It is a customary business practice for a corporation to maintain a stock register to keep track of stock certificates, capital stock issued, dates of changes, changes in treasury stock, and to

record future changes in ownership. RCW 48.05.280 states: "Every insurer shall keep full and adequate accounts and records of its assets, obligations, transactions and affairs.

The Company is instructed to maintain a stock register in order to meet the full and adequate accounts and records requirement of RCW 48.05.280.

8. Investment Management Fees

The Company receives investment management services from Winterthur Investment Management Corporation (WIMCO) an affiliate. The Investment Management Agreement which was approved by OIC requires management fees to be based on actual costs incurred by WIMCO. The Company was not able to provide records to support the costs incurred by WIMCO in providing investment management services to the Company. The Company did provide a summary record on the billing allocation method used by WIMCO which is based on actual costs but without the records and details to support those costs we were not able to determine the reasonableness of the billings charged to the Company.

This is in violation of the Insurer Holding Company Act (RCW 48.31B.030), which states "...the books, accounts, and records of each party...must be so maintained as to clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties."

The Company is instructed to comply with RCW 48.31B.030 by maintaining its books, accounts, and records so that they clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges.

9. Prior Approval Required for Cost-Sharing Agreement

The Company's Cost-Sharing Agreement involved the following affiliates within the Unigard Insurance Company Group: National Merit Insurance Company (NMIC), Unigard Pacific Insurance Company, Unigard Insurance Company (UIC) and Unigard Indemnity Company (UID). The agreement was implemented on January 1, 1998, which was prior to the Commissioner's approval date of April 6, 1999, and prior to its filing of Form D on January 7, 1999. RCW 31B.030(1)(b) states that a service agreement "...involving a domestic insurer and a person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into the transaction and the commissioner declares the notice to be sufficient at least sixty days before, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period." The Company implemented its Cost-Sharing Agreement with its affiliates prior to receiving approval from the OIC.

The Company is instructed to comply with RCW 48.31B.030(1)(b) which requires prior approval of agreements involving persons in its holding company system.

10. Earned But Unbilled (EBUB) Premium

The Company did not disclose and record EBUB correctly in its Annual Statements for the five years under examination. EBUB refers to the additional premium charged due to changes of insurance risk exposure during the policy period. Almost all commercial policies of Unigard Insurance Company are subject to such after-period audits and adjustments. SSAP 53 requires that EBUB be estimated as of the statement date and that 10% be recorded as a non-admitted asset. The Company estimated the amount of EBUB but failed to record 10% as a non-admitted asset. In addition, the Company did not disclose EBUB in the description column of the balance sheet line, Premiums and Agents' Balances and Installments Booked but Deferred and Not Yet Due, as required in the NAIC Annual Statement Instructions. The non-disclosure and 10% non-admission error occurred during the entire examination period of January 1, 1997 to December 31, 2002.

Pursuant to RCW 48.05.073, the Company is instructed to correctly record EBUB in the NAIC Annual Statement as required by SSAP 53, paragraph 9, and to properly disclose the amount of EBUB as required in the NAIC Annual Statement Instructions.

Subsequent to the date of this examination, the Company has corrected its method of recording EBUB, and the related non-admitted assets.

11. Amortization of Goodwill in Operating Statement

The Company incorrectly recorded \$758,563 of goodwill amortization directly to the Statement of Income. The recorded amortization was from the Company's purchase of Federated American Insurance Company (now UPIC), and NMIC. Both companies are considered subsidiary, controlled, and affiliated (SCA) entities. SSAP No. 68 paragraph 7 states "Positive or negative goodwill resulting from the purchase of a SCA shall be amortized to Unrealized Capital Gains and Losses on investments over the period in which the acquiring entity benefits economically, not to exceed 10 years." Recording goodwill amortization to the Statement of Income instead of directly to Capital and Surplus understates net income but does not affect surplus.

The Company is instructed to properly classify goodwill amortization on the NAIC Annual Statement as required by RCW 48.05.073 and SSAP No. 68. In order to properly reflect goodwill amortization in our examination report, the following reclassification is needed:

	<u>Debit</u>	<u>Credit</u>
Net unrealized capital gains or (losses)	\$758,563	
Net investment income earned		\$758,563

Subsequent to the date of this examination and prior to the last day of field work, the Company made the above entry.

12. Indemnity Agreement - Non Admitted Assets

The Company incorrectly reduced Incurred but Not Reported (IBNR) reserves by \$8,516,000 based on a threshold clause that was triggered in the year 2002 in an Indemnity Agreement with John Hancock Property and Casualty Holding Company. This is a non-collateralized indemnity agreement which meets the requirement of SSAP No. 4 as a non-admitted asset. Non-admitted assets cannot be included as an admitted asset, or as an offset to an existing liability account for statutory accounting principles. SSAP No. 4 paragraph 3 states that for statutory accounting principles, a non-admitted asset shall be defined as:

- a. “Specifically identified within the Accounting Practices and Procedures Manual as a non-admitted asset; or
- b. Not specifically identified as an admitted asset within the Accounting Practices and Procedures Manual.”

SSAP No. 20 paragraph 4.b. specifically identifies receivables that are not for premiums and that are not collateralized as a non-admitted asset.

Pursuant to RCW 48.05.073, the Company is instructed to non admit offsets to reserves based on the Indemnity Agreement with John Hancock. However, no adjustment was required for the Examination period ending December 31, 2002 due to OIC’s actuarial review. The OIC review determined that reserves, which were reduced for the Indemnity Agreement offset, were adequate or within a reasonable range as stated in the 2002 NAIC Annual Statement. On a go forward basis, there is no guarantee the reserves would remain adequate after the offset is applied, therefore the offset must be non-admitted in future reserve calculations.

COMMENTS AND RECOMMENDATIONS

None

COMPANY PROFILE

History

Unigard Insurance Company (UIC), the lead company of the Unigard Insurance Group, was incorporated as Northwestern Security Insurance Company on September 29, 1960 under the laws of the state of Washington. The name of the company was changed to Unigard Insurance Company on September 14, 1968.

Territory and Plan of Operation

UIC is a multi-line, property and casualty insurance company operating primarily in the 6 western states of Arizona, California, Idaho, Oregon, Utah, and Washington. In Washington, UIC is authorized to write participating and non-participating policies for disability, property, marine and transportation, vehicle, general casualty and surety as defined in RCW 48.11.030 through RCW 48.11.080.

Acquisitions, Mergers, Disposals, Dissolutions, Purchases, And Sales

UIC is a wholly-owned subsidiary of Unigard, Inc., a non-insurance holding company, which also owns Wincorp, Inc., a commercial insurance premium finance company. On July 1, 1993, Unigard Security Insurance Company (USIC), the former parent of Unigard, Inc., sold Unigard, Inc., and its subsidiaries to Winterthur U.S. Holdings, Inc., a Delaware Corporation and wholly-owned subsidiary of Winterthur Swiss Insurance Company. Winterthur Swiss Insurance Company and its subsidiaries are members of the Credit Suisse Group.

On December 9, 1997, UIC purchased all of the outstanding shares of Federated American Insurance Company (FAIC), now named Unigard Pacific Insurance Company (UPIC), and its subsidiary, National Merit Insurance Company (NMIC). Shortly thereafter, NMIC became a wholly-owned subsidiary of UIC, and a sister company of FAIC, through an approved dividend transaction.

Growth of Company

The following schedule shows the Company's growth for selected categories as reported in its NAIC annual statements:

<u>Year</u>	<u>Net Premiums Written</u>	<u>Net Losses Paid</u>	<u>Admitted Assets</u>	<u>Surplus as Regards Policyholders</u>
1997	\$ 209,568,794	\$ 145,064,485	\$ 496,356,381	\$ 199,484,815
1998	184,392,831	118,920,150	517,905,309	235,234,584
1999	175,591,660	117,674,534	448,257,474	181,577,879
2000	189,171,262	111,205,228	464,317,555	178,471,010
2001	216,566,995	117,943,317	457,039,758	187,100,228
2002	236,361,632	126,099,664	470,705,098	167,791,337

AFFILIATED COMPANIES

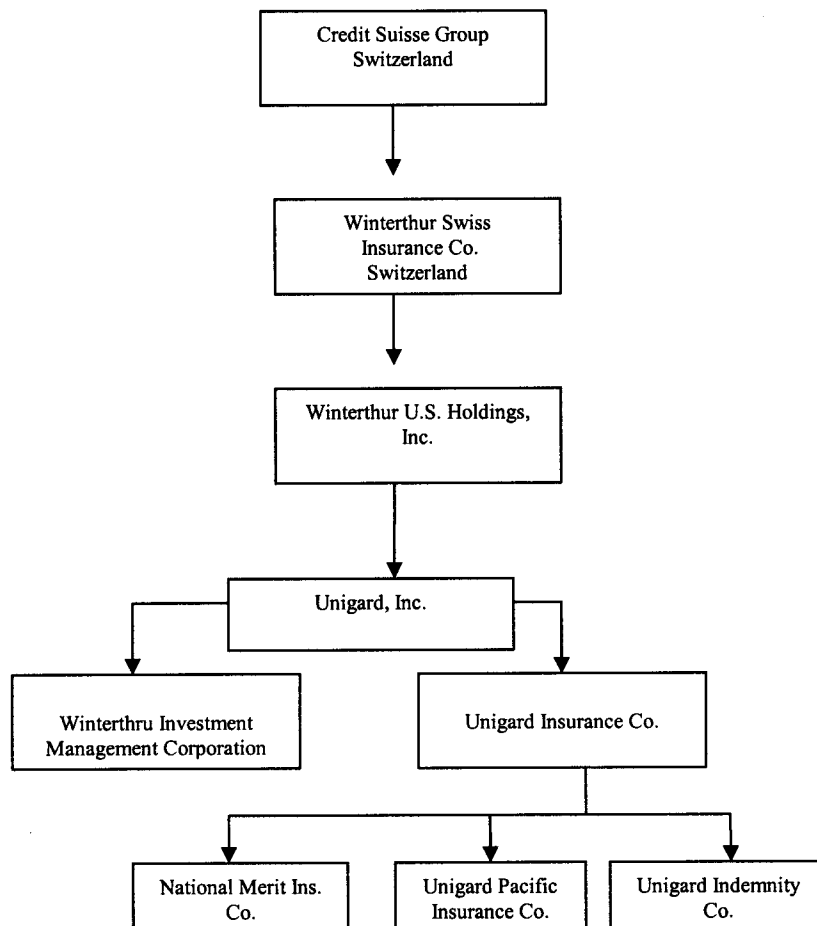
The Company is a wholly-owned subsidiary of Unigard, Inc. All of the voting stock of Unigard, Inc., is owned by Winterthur U.S. Holdings, Inc., a Delaware Corporation and a wholly-owned subsidiary of Winterthur Swiss Insurance Company. Winterthur Swiss Insurance Company and its affiliates are members of the Credit Suisse Group. As a member of an insurance holding company system, registration statements are required to be filed in accordance with RCW 48.31B.025 and WAC 284-18-300. Winterthur U.S. Holdings, Inc., filed registration statements for each year under examination on behalf of the Unigard Insurance Group. The Company provides all operating services for UID, UPIC, and NMIC, with reimbursement pursuant to service agreements between the parties.

Winterthur Investment Management Corporation, an affiliate, provides all the investment services for UIC pursuant to an asset management/investment services agreement dated January 1, 1999.

Beginning in 1993, the income tax return of UIC has been consolidated with Winterthur U.S. Holdings, Inc., and its subsidiaries. The method of allocation between the companies is subject to a written agreement that became effective on December 10, 1993 and amended on December 9, 1997. The agreement requires taxes to be allocated based on separate return calculations. These calculations result in a tax charge (or refund) of not more than the amount each company would have paid (or received) had it filed a separate return with the IRS.

On January 1, 1998, the Company entered into an amended inter-company pooling agreement with two of its wholly owned subsidiaries, UID and UPIC. Under the terms of this agreement, UIC assumes all of UID's and UPIC's net underwriting activity. The Company then cedes back to UID and UPIC, 10% and 4%, respectively, of the pooled business net of cessions to third party reinsurers.

The following organization chart depicts the direct organizational reporting structure of the Unigard group of companies as of December 31, 2002:



MANAGEMENT AND CONTROL

Ownership

The original authorized capital of UIC was \$1,000,000 which consisted of 10,000 shares of \$100 par value common stock. Unigard Security Insurance Company (USIC) subscribed and purchased all the authorized stock at \$300 per share for a total of \$3,000,000 with allocation of \$1,000,000 to paid-up capital and \$2,000,000 to paid-in surplus. On September 30, 1985, USIC contributed \$5,100,000 capital to Unigard, Inc., which in turn contributed the same amount to UIC.

On May 8, 1986, the Board of Directors approved the increase of capital stock from \$1,000,000 to \$2,500,000. The \$1,500,000 was transferred from paid in surplus to capital stock.

On August 9, 1990, the Board of Directors approved a resolution transferring 100% ownership of Unigard Indemnity Company (UID) from Unigard, Inc., to the Company

and declared USIC's contribution of \$10,000,000 of capital assets to the Company. On November 30, 1990, Unigard, Inc., transferred stock ownership of UID to the Company. On December 21, 1990, USIC contributed \$10,000,000 to the Company which increased gross paid in surplus to \$28,482,063.

On December 15, 1993, Unigard, Inc., contributed \$66,071,508 to the Company. This transfer increased gross paid in surplus to \$94,053,571. On November 30, 1994, Unigard, Inc., contributed \$25,000,000 to the Company which increased gross paid in surplus to \$119,053,571.

Currently, the authorized capital of the Company is \$3,000,000 consisting of 30,000 common shares at \$100 par value per share. All authorized shares are outstanding.

Over the course of the time period under examination, the Company paid the following dividends to its parent, Unigard, Inc.:

<u>Date</u>	<u>Dollar Amount</u>
March 13, 1997	\$ 2,100,000
June 12, 1997	\$ 1,200,000
December 15, 1999	\$ 60,000,000
December 15, 2000	\$ 7,000,000
September 12, 2002	\$ 2,500,000
December 20, 2002	\$ 2,500,000

The \$60,000,000 dividend paid on December 15, 1999, considered an extraordinary dividend under Washington and California state law, was approved by the insurance departments of both states prior to payment.

Board of Directors

Article I, Section 1 of the Bylaws states that the business affairs of the Company shall be conducted by a Board of not less than seven (7) or more than seventeen (17) directors. The directors are elected at each annual shareholder meeting and hold office for one year.

The following directors, officers and committee members served the Company as of December 31, 2002:

<u>Directors</u>	<u>Principal Business Affiliation</u>	<u>Residence</u>
Peter Christen	Chairman, President & CEO Unigard Insurance Group	Washington
John P. McPeak	Vice President & CFO	

	Unigard Insurance Group	Washington
Toni G. Rotz	Vice President, Personal Lines Unigard Insurance Group	Washington
L. Arnold Chatterton	Vice President, Marketing Services Unigard Insurance Group	Washington
Cheryl L. Lang	Vice President, Human Resources Unigard Insurance Group	Washington
Jeffrey R. Dehn	Vice President, Commercial Lines Unigard Insurance Group	Washington
Kenneth C. Dedrick	Vice President, Claims Unigard Insurance Group	Washington
Paul D. Neuss	Vice President, Operations Unigard Insurance Group	Washington

Article 1 Section 4 of the Bylaws provides that the Board shall appoint from among its members an Executive Committee composed of not less than three (3) members, including the President and the Chairman of the Board. The Executive Committee shall have full power to act for the Board ad interim. The Executive Committee is comprised of the following individuals:

Peter Christen
Cheryl Lang
John McPeak

Officers

Elected Officers

Article I, Section 2 of the Bylaws provide that the following key positions of the Company shall be elected by the Board of Directors: Chairman of the Board, President, Executive Vice President, such number of Senior Vice Presidents, and Vice Presidents as the Board may determine, and General Counsel. The elected positions as of December 31, 2002 were as follows:

<u>Name</u>	<u>Title</u>
Peter Christen	Chairman of the Board, President & CEO
John P. McPeak	Vice President & Chief Financial Officer
Andreas F. Braendle	Vice President, Information Systems
L. Arnold Chatterton	Vice President, Marketing Services

Kenneth C. Dedrick	Vice President, Claims
Jeffrey R. Dehn	Vice President, Commercial Lines
Cheryl L. Lang	Vice President, Human Resources
Paul D. Neuss	Vice President, Operations
Toni G. Rotz	Vice President, Personal Lines
Scott A. Kallander	General Counsel

Appointed Officers

Article I, Section 3 of the Bylaws provides that the Chief Executive Officer may from time to time designate a Controller, Treasurer, Secretary and any number of Assistant Vice Presidents and Assistant Secretaries. The appointed officers as of December 31, 2002 were as follows:

Scott Kallander	Secretary
LeAnn Weese	Assistant Vice President, Accounting & Treasurer
Chris Alberghini	Assistant Vice President, Marketing Services
Deirdre Ashlock	Assistant Vice President, Commercial Lines
Sherida Bradley	Assistant Vice President, Northwest Field Operations
Norm Donelson	Assistant Vice President, Actuarial
John Doocy	Assistant Vice President, Information Systems Operations
Doug Furman	Assistant Vice President, Claims
Jerry Lemmon	Assistant Vice President, Information Systems
John Scott	Assistant Vice President, Claims
Eric Spencer	Assistant Vice President, Claims
Diana Van Horn	Assistant Vice President, Intermountain Field Operations
Cindy Woodford	Assistant Vice President, Personal Lines

Conflict of Interest

The Company has policies and procedures to identify any conflict of interest of the directors, officers, and exempt employees. Each officer and director submits a signed conflict of interest statement to the Corporate Legal Department on an annual basis. Each exempt employee submits a signed conflict of interest statement to the Corporate Legal Department every three years. Any reported exceptions that might be considered conflicts of interest are reported to the Board of Directors or its Executive Committee. No material exceptions were noted

Fidelity Bond and Other Insurance

Winterthur U. S. Holdings, Inc., an affiliate, has a financial institution bond policy that includes coverage for its subsidiaries. The aggregate liability covered by the bond is \$10,000,000 which exceeds the NAIC recommended amount.

Winterthur U.S. Holdings, Inc., also has a program of coverage for its subsidiaries that includes: casualty excess, umbrella, employment practices, professional liability, directors and officer's liability, and fiduciary liability insurance.

The Company's property and general liability coverage are provided through an independent agency, i.e., they are underwritten by insurance companies other than those in the Unigard Group.

Officer's, Employees', and Agents' Welfare and Pension Plans

The Company provides its employees and their dependents with medical, dental, vision care, life and AD&D benefits. In addition, under Unigard's Pre-Tax Flexible Benefit Plan, employees can take advantage of paying their share of the expense in the plans with pre-tax or tax free dollars.

The Company's employees are eligible to participate in the Company's pension plan, a long term disability plan, and a voluntary defined contribution savings plan. The Company made adequate provisions in the financial statements for its obligations under these plans.

CORPORATE RECORDS

The Company's minutes from the Stockholder, Director, and Committee meetings documented disclosure and approval of the Company's transactions and events. The previous examination report was reviewed by the Company's directors.

LOSS EXPERIENCE

The reserves carried by the Company for unpaid losses and loss adjustment expenses were \$134,690,874 and \$31,050,818, respectively, as of December 31, 2002.

The reserves and an actuarial report prepared by the Company's consulting actuarial firm, Tillinghast-Towers Perrin, were reviewed by the OIC's actuarial staff. Company personnel provided loss and loss adjustment expense development data by accident year and line of business as of December 31, 2002.

Based on the analysis of data through December 31, 2002, the OIC's actuarial staff concluded that the Company's booked reserves for unpaid losses and unpaid loss adjustment expenses as of December 31, 2002 were within a reasonable range. Therefore, the reserves were accepted as shown in the 2002 Annual Statement.

REINSURANCE

The Company cedes and assumes reinsurance. All reinsurance agreements in effect as of December 31, 2002 were reviewed and the coverage is summarized as follows:

Reinsurance Ceded

The Company and its subsidiaries, UID, UPIC, and NMIC are collectively reinsured under a variety of reinsurance treaties. The Company is in compliance with the Washington Insurance Code and NAIC guidelines regarding authorized and unauthorized reinsurers. The agreements include the insolvency clause required under RCW 48.12.160(2).

The following schedule summarizes the Companies' ceded reinsurance treaty coverage in force as of December 31, 2002:

<u>Property</u>	<u>Company Retention</u>	<u>Reinsurers' Limits</u>
First Per Risk Excess	\$500,000 \$750,000 annual aggregate deductible	\$1,500,000 excess of retention, \$4,500,000 per occurrence \$3,000,000 for terrorism
Second Per Risk Excess	\$2,000,000	\$3,000,000 excess of retention, \$6,000,000 per occurrence \$3,000,000 for terrorism
Third Per Risk Excess	\$5,000,000	\$5,000,000 excess of retention, \$5,000,000 per occurrence \$5,000,000 for terrorism
Facultative Excess Binding Agreement	\$10,000,000 per risk	\$20,000,000 excess of retention per risk
First Catastrophe Excess	\$5,000,000	95% of \$5,000,000 excess of retention, ultimate net loss per occurrence
Second Catastrophe Excess	\$10,000,000	95% of \$110,000,000 excess of retention, ultimate net loss per occurrence

Equipment Breakdown Coverage	\$0	\$25,000,000 per accident
------------------------------	-----	---------------------------

<u>Yacht</u>	<u>Company Retention</u>	<u>Reinsurers' Limits</u>
Yacht Excess Automatic Facultative	Hull \$250,000	Hull \$1,250,000 excess of retention
<u>Note:</u> This agreement was cancelled 4/1/02 and provides one year of runoff coverage for policies in force on that date.	P&I \$300,000	P&I \$700,000 excess of retention

<u>Casualty</u>	<u>Company Retention</u>	<u>Reinsurers' Limits</u>
First Excess	\$500,000 per occurrence	\$500,000 excess \$500,000 per occurrence
Second Excess	\$1,000,000 per occurrence	\$4,000,000 excess \$1,000,000 per occurrence
Third Excess	\$5,000,000 per occurrence	\$5,000,000 excess \$5,000,000 per occurrence
Fourth Workers' Compensation (WC) Excess	\$10,000,000 per occurrence	\$10,000,000 excess \$10,000,000 per occurrence
Personal Umbrella Quota Share Automatic Facultative	\$200,000 (20% First \$1,000,000)	80% First \$1,000,000 100% Next \$4,000,000
Commercial Umbrella Quota Share Automatic Facultative	\$150,000 (15% First \$1,000,000)	85% First \$1,000,000 100% Next \$14,000,000

Reinsurance Assumed

The Company's assumed reinsurance is derived primarily from its subsidiary, UID, and its former affiliate, USIC.

UID, as part of the inter-company pooling agreement which became effective July 1, 1993, automatically cedes to the Company all gross liabilities incurred under or in connection with all contracts and policies of insurance issued by the UID. Subsequently, UIC retro-ceded 14% of this business to UID. This agreement was modified on January 1, 1998 as a result of the Company purchasing UPIC. Under the new agreement, the Company assumes all of UID's and UPIC's net underwriting activity and cedes back to

UID and UPIC 10% and 4%, respectively, of the pooled business net of cessions to third party reinsurers.

Unigard Security Insurance Company and Winterthur U.S. Holdings, Inc., entered into a stock purchase agreement as of September 24, 1993 which provided for the sale of all the capital stock of Unigard, Inc., the holder of all the issued and outstanding capital stock of UIC (holder of all the issued and outstanding capital stock of UID).

Under the terms of the Stock Purchase Agreement, the Company and UID entered into a 100% quota share agreement with USIC as of December 10, 1993. The Company agreed to assume "...on the terms and conditions and for considerations hereinafter contained, a 100% Quota Share of the Ceding Company's, i.e. USIC's, insurance liabilities and obligations, after reduction for collectible Third Party Reinsurance, and all risks, past, present and future with respect to all business conducted or to be conducted by the Ceding Company but excluding the Excluded Business (the "Business Covered")."

Amendment Number One dated December 31, 1996 states that the Stock Purchase Agreement shall continue in full force and effect through December 31, 1997. The parties agreed that the Ceding Company will not write any new business after December 31, 1996.

STATUTORY DEPOSITS

At December 31, 2002, the Company had the following statutory deposits:

<u>State</u>	<u>Type</u>	<u>Par Value</u>	<u>Market Value</u>
Arizona	Bonds	\$ 3,250,000	\$ 3,828,903
California	Bonds	\$ 8,500,000	\$10,039,375
Idaho	Bonds	\$ 70,000	\$ 77,743
New Mexico	Bonds	\$ 350,000	\$ 388,717
North Carolina	Bonds	\$ 350,000	\$ 389,561
Oregon	Bonds	\$ 800,000	\$ 887,496
Washington	Bonds	\$ 2,700,000	\$ 2,998,674

ACCOUNTING RECORDS AND PROCEDURES

The Company's accounting functions are processed through a purchased accounting software program operated at its home office in Bellevue, Washington. The Company provides accounting services to its affiliates through an inter-company service and management agreement. In addition, the Company and its affiliates receive investment services from WIMCO according to an investment management agreement.

Data for all four affiliates (UPIC, UIC, NMIC, and UID) are entered into the same general ledger system. Company codes are used to identify and separate each company's data. This system produces a trial balance that can be downloaded into a Lotus spreadsheet and used for financial reporting. Booke software is used to prepare the NAIC Annual Statement. Investment accounting for marketable securities is processed by Sunguard, a personal computer (PC) based software package.

The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning phase of the examination and a trial balance prepared for the year ended December 31, 2002. No exceptions were noted.

SUBSEQUENT EVENTS

The following subsequent events were noted:

1. During the fourth quarter of 2003, Winterthur US Holdings, Inc., the parent of Unigard, Inc., announced that it would create a new service company called Winterthur North America (WNA), which will be located in Wisconsin. WNA will provide actuarial, financial, human resource, information technology, legal, and corporate marketing services to companies within Winterthur US Holdings, including Unigard Insurance Company and its affiliates. It was announced that about 40 positions in information technology, human resources, and accounting would be eliminated. Most of the financial and accounting functions will be phased out near the end of 2004 and handled by the new service company, WNA. Transition to the new service arrangement will involve significant system conversions, training, and reporting line changes.
2. National Merit Insurance Company (NMIC), a direct writer of property and casualty insurance products was sold to Response Insurance effective after close of business on December 31, 2003.
3. On February 24, 2003, the Company paid a \$2,500,000 dividend to its parent Unigard, Inc.

4. In the first quarter of 2003, the Company appointed Andreas F. Braendle (Vice-President of Information Systems) to the Board of Directors. He replaced Paul D. Neuss, the former Vice-President of Operations.
5. On August 21, 2003, the Company paid a \$2,500,000 dividend to its parent, Unigard, Inc.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

There were no instructions, comments, or recommendations made during the last examination.

FINANCIAL STATEMENTS

Statement of Assets.....	Page 20
Statement of Liabilities, Surplus and Other Funds.....	Page 21
Statement of Income.....	Page 22
Capital and Surplus Account.....	Page 23
Five Year Reconciliation of Capital and Surplus	Page 24

UNIGARD INSURANCE COMPANY
STATEMENT OF ASSETS
AS OF DECEMBER 31, 2002

	<u>BALANCE</u> <u>PER COMPANY</u>	<u>EXAMINATION</u> <u>ADJUSTMENTS</u>	<u>BALANCE PER</u> <u>EXAMINATION</u>
Assets			
Bonds	\$ 258,295,650		\$ 258,295,650
Stocks:			
Common stocks	59,779,821		59,779,821
Real estate:			
Properties occupied by the company	31,717,461		31,717,461
Properties held for production of income	4,579,749		4,579,749
Cash and short-term investments	27,476,442		27,476,442
Other invested assets	5,135,353		5,135,353
Subtotals, cash and invested assets	<u>386,984,476</u>		<u>386,984,476</u>
 Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	8,899,810		8,899,810
Premiums, agents' balances and installments booked but deferred and not yet due	45,177,866		45,177,866
Reinsurance recoverables on loss and loss adjustment expense payments	4,557,213		4,557,213
Federal income tax recoverable and interest thereon	19,305,763		19,305,763
Electronic data processing equipment & software	1,285,945		1,285,945
Interest, dividends and real estate income due and accrued	2,819,510		2,819,510
Receivable from parent, subsidiaries and affiliates	759,224		759,224
Aggregate write-ins for other than invested assets:	915,291		915,291
 Total Assets	 <u><u>\$ 470,705,098</u></u>	 <u><u>0</u></u>	 <u><u>\$ 470,705,098</u></u>

UNIGARD INSURANCE COMPANY
STATEMENT OF LIABILITIES, SURPLUS AND OTHER FUNDS
AS OF DECEMBER 31, 2002

	<u>BALANCE</u> <u>PER COMPANY</u>	<u>EXAMINATION</u> <u>ADJUSTMENTS</u>	<u>BALANCE PER</u> <u>EXAMINATION</u>
Liabilities			
Losses	\$ 134,690,874		\$ 134,690,874
Loss adjustment expenses	31,050,818		31,050,818
Commissions payable, contingent commissions & other similar charges	6,934,829		6,934,829
Other expenses (excluding taxes, licenses and fees)	11,451,268		11,451,268
 Taxes, licenses and fees (excluding federal and foreign income taxes)	 918,799		 918,799
Borrowed money interest thereon	48,561		48,561
Unearned premiums	107,714,792		107,714,792
Advance premiums	3,471,607		3,471,607
Ceded reinsurance premiums payable (net of ceding commissions)	2,806,197		2,806,197
Funds held by company under reinsurance treaties	26,800		26,800
Amounts withheld or retained by company for account of others	388,017		388,017
Remittances and items not allocated	20,966		20,966
Provision for reinsurance	402,200		402,200
Aggregate write-ins for liabilities	2,988,033		2,988,033
Total Liabilities	<u>302,913,761</u>		<u>302,913,761</u>
 Surplus and Other Funds			
Common capital stock	3,000,000		3,000,000
Gross paid in and contributed surplus	119,053,571		119,053,571
Unassigned funds (surplus)	45,737,766		45,737,766
Surplus as regards policyholders	<u>167,791,337</u>		<u>167,791,337</u>
 Total Liabilities, Surplus and Other Funds	<u>\$ 470,705,098</u>	<u>\$ 0</u>	<u>\$ 470,705,098</u>

UNIGARD INSURANCE COMPANY
STATEMENT OF INCOME
FOR THE YEAR-ENDED DECEMBER 31, 2002

Loss expenses incurred	28,881,673	28,881,673
Other underwriting expenses incurred	72,613,704	72,613,704
Total underwriting deductions	<u>234,398,930</u>	<u>234,398,930</u>
Net underwriting gain or (loss)	<u>(11,648,711)</u>	<u>(11,648,711)</u>
Investment Income		
Net investment income earned	11,595,819	11,595,819
Net realized capital gains or (losses)	<u>(18,920,204)</u>	<u>(18,920,204)</u>
Net investment gain or (loss)	<u>(7,324,385)</u>	<u>(7,324,385)</u>
Other Income		
Net gain or (loss) from agents' or premium balances charged off	(501,552)	(501,552)
Finance and service charges not included in premiums	2,117,860	2,117,860
Aggregate write-ins for miscellaneous income	<u>(11,011,670)</u>	<u>(11,011,670)</u>
Total other income	<u>(9,395,362)</u>	<u>(9,395,362)</u>
Net income before dividends to policyholders and before federal and foreign income taxes	(28,368,458)	(28,368,458)
Net income, after dividends to policyholders but before federal and foreign income taxes	<u>(28,368,458)</u>	<u>(28,368,458)</u>
Federal and foreign income taxes incurred	4,906,000	4,906,000
Net Income	<u>\$ (23,462,458)</u>	<u>\$ 0 \$ (23,462,458)</u>

UNIGARD INSURANCE COMPANY
CAPITAL AND SURPLUS ACCOUNT
AS OF DECEMBER 31, 2002

	<u>BALANCE</u> <u>PER COMPANY</u>	<u>EXAMINATION</u> <u>ADJUSTMENTS</u>	<u>BALANCE PER</u> <u>EXAMINATION</u>
Surplus as Regards Policyholders, December 31 Prior Year	\$ 187,100,230		\$ 187,100,230
Gains and (Losses) in Surplus			
Net income	(23,462,458)		(23,462,458)
Net unrealized capital gains or (losses)	3,362,227		3,362,227
Change in net deferred income tax	4,672,000		4,672,000
Change in non-admitted assets	1,521,538		1,521,538
Change in provision for reinsurance	(337,400)		(337,400)
Dividends to stockholders (cash)	(5,000,000)		(5,000,000)
Aggregate write-ins for gains and losses in surplus	(64,800)		(64,800)
 Change in surplus as regards policyholders for the year	 <u>(19,308,893)</u>		 <u>(19,308,893)</u>
 Surplus as Regards Policyholders, December 31 Current Year	 <u>\$ 167,791,337</u>	 <u>0</u>	 <u>\$ 167,791,337</u>

UNIGARD INSURANCE COMPANY
RECONCILIATION OF SURPLUS FOR THE PERIOD SINCE THE LAST EXAMINATION
FOR THE FIVE YEARS ENDING DECEMBER 31

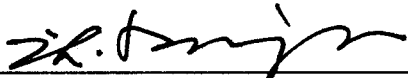
Policyholders, December 31 Prior Year	\$187,100,230	\$178,471,010	\$181,577,877	\$235,234,584	\$199,484,815
Gains and (Losses) in Surplus					
Net Income	(23,462,458)	2,934,423	7,624,916	28,729,449	22,106,297
Net unrealized capital gains or (losses)	3,362,227	(671,386)	(3,599,964)	(22,817,834)	12,080,621
Change in net deferred income tax	4,672,000	2,840,000			
Change in non-admitted assets	1,521,538	(4,687,277)	(531,818)	(86,322)	493,851
Change in provision for reinsurance	(337,400)	(11,400)	11,600	268,600	(33,600)
Cumulative effect of changes in accounting principles		8,963,452			
Change in excess of statutory reserves over statement reserves				518,000	969,000
Dividends to stockholders (cash)	(5,000,000)	-	(7,000,000)	(60,000,000)	-
Aggregate write-ins for gains and losses in surplus	(64,800)	(738,592)	388,399	(268,600)	133,600
Change in surplus as regards policyholders for the year	<u>(19,308,893)</u>	<u>8,629,220</u>	<u>(3,106,867)</u>	<u>(53,656,707)</u>	<u>35,749,769</u>
Capital and Surplus as Regards					
Policyholders, December 31 Current Year	<u>\$167,791,337</u>	<u>\$187,100,230</u>	<u>\$178,471,010</u>	<u>\$181,577,877</u>	<u>\$235,234,584</u>

ACKNOWLEDGMENT

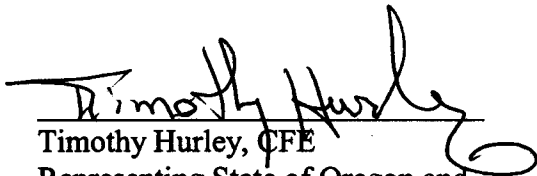
Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Unigard Insurance Company during the course of this examination.

In addition to the undersigned, Mike Jordan, CPA, CFE, MHP; Carl Baker, CPA, CISA, AFE; Bert Karau, CPA; Jeanette Liao; Kathy Hicks, CPA; Mitch Coe, CPA; Tarik Subbagh, CPA; D. Lee Barclay, FCAS, MAAA; Eric Slavich; and John Jacobson, AFE, all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,



Timoteo L. Navaja, CFE, CIE
Examiner-in-Charge
State of Washington



Timothy Hurley, CFE
Representing State of Oregon and
NAIC Western Zone

AFFIDAVIT

STATE OF WASHINGTON

}

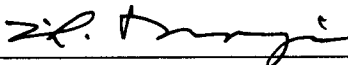
} ss

COUNTY OF KING

}

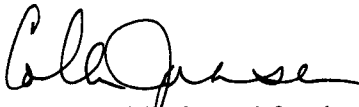
Timoteo L. Navaja, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Unigard Insurance Company was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).



Timoteo L. Navaja, CFE, CIE
Examiner-In-Charge
State of Washington

Subscribed and sworn to before me this 19th day of October, 2004.



Notary Public in and for the
State of Washington.

